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LEGAL DIVISION

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OIL AND GAS DOCKET NO. 2-97041 FEBRUARY 27, 1992

APPLICATION OF MICHAEL R. MULVEY PURSUANT TO THE MINERAL INTEREST POOLING ACT TO POOL INTO THE PECOS DEVELOPMENT CORPORATION'S BLOCK 71 UNIT, WELL NO. 2, CLAYTON (WILCOX 7360) FIELD, LIVE OAK COUNTY.

APPEARANCES:

	Representing:
Applicant:	
Lloyd Muennink	Michael R. Mulvey
Michael R. Mulvey	Self
Mark Nibbelink	Michael R. Mulvey
Protestant:	
Calhoun Bobbitt	Pecos Development Corp., Bay Rock Operating Co., US Energy Search, Inc.
John MacDiarmid	Bay Rock Operating Co.

PROCEDURAL HISTORY

Date of Application	September 16, 1991
Notice of Hearing	September 25, 1991
Hearing Held	November 1, 1991
PFD Circulated	February 27, 1992

Heard by: Larry Borella, Hearings Examiner
Ron Schultz, Hearings Examiner
Thomas H. Richter, Technical Examiner

PROPOSAL FOR DECISION

STATEMENT OF THE CASE

This is a Mineral Interest Pooling Act application of Michael R. Mulvey (hereafter Mulvey) for a Commission order establishing a unit and pooling his interest in several tracts of land into the existing Pecos Development Corporation Block 71-2 Unit, Clayton (Wilcox 7360) Field, Live Oak County. Bay Rock Operating Company (hereafter Bay Rock) operates the Pecos Development Corporation (hereafter Pecos) Block 71 Well No. 2. This field, discovered on January 11, 1975, has field rules requiring 160 acre proration units.

DISCUSSION OF EVIDENCE AND EXAMINER'S OPINION

Undisputed evidence shows that:

a. the Clayton (Wilcox 7360) Field was discovered after March 8, 1961,

b. field rules require 160 acre proration units, plus 10% tolerance,

c. no State owned land is involved,

d. separately owned tracts of land overlay a common reservoir,

e. the parties have drilling rights,

f. the parties own separate interests in oil and gas in the proposed unit and have no voluntary pooling agreement.

It is also undisputed that Mulvey made a pooling offer to Pecos and Bay Rock (Mulvey Ex. 1). Mulvey's offer, dated August 27, 1991, was made to Bay Rock and to the other working interest parties. Mulvey's offer proposed: (1) a 226 acre unit composed of tracts 3364, 3365, 3366, 3367, 3369, and 3370, (2) the selection of a new operator under terms of a 1951 Western Natural Gas Block 71 Operation Agreement, and (3) that Mulvey would pay 125% of his working interests cost to be deducted from production proceeds. The offer expressly excluded the prohibited provisions enumerated in Texas Natural Resources Code § 102.015. Pecos and Bay Rock contend that the offer was not a fair and reasonable offer to pool. Ownership of mineral rights is also disputed in part of the proposed unit. Although the Commission has no jurisdiction to determine title to land, each tract of the proposed unit must be reviewed to determine if Mulvey has demonstrated a good faith claim to the interests he seeks to pool before addressing the reasonableness of the offer.

SEPARATE TRACTS CONSIDERATION

The proposed unit includes all or part of the following tracts located in Farm Block 71 of the Dr. Charles F. Simmons Nueces River Farm Subdivision in Live Oak County: 3364, 3365, 3366, 3367, 3369, 3370. Mulvey's claim to 1/32nd interest in tracts 3364 and 3365 is contractually derived from an operating agreement. Bay Rock (who owns the remaining interests) claims, in a pending civil lawsuit, that this agreement has expired and asserts that 31/32 of the interests covered therein have entered into a new operating agreement. Mulvey claims a .375 interest in tract 3366, being an undivided 25% leased interest and a 1/8th mineral interest in fee. Likewise, Mulvey claims by lease, a 25% interest in tract 3367. Mulvey claims a 100% leased interest in tract 3369. In tract 3370 Mulvey claims a 6.25% mineral ownership and a leased interest of 25%. In the civil suit pending in Live Oak County, Pecos has counterclaimed that tracts 3366, 3367, 3369 and 3370 are subject to a constructive trust in their favor and have filed a lis pendens on those tracts. Mulvey has established the requisite good faith claim on the tracts he seeks to pool.

FAIR AND REASONABLE OFFER

Bay Rock contends that the offer made by Mulvey was not fair and reasonable for the following reasons: (1) the offer proposes that a new operator be selected by the majority of the working interest ownership, and that the selection process be governed by the 1951 Western Natural Gas Block 71 Operating Agreement, (2) the offer to pay costs was inadequate, (3) the proposed unit includes more acreage than the field rules allow, (4) the offer disparages title to some tracts in the existing unit. Bay Rock correctly asserts that a fair and reasonable offer is a jurisdictional prerequisite to a Mineral Interest Pooling Act (MIPA) pooling order and requests that the application be dismissed for lack of a fair and reasonable offer. Texas Natural Resources Code § 102.013(b). (Vernons 1978). An analysis of each of Bay Rock's concerns follows.

New Operator Selection and Controlling Operating Agreement

Mulvey's offer states "I propose that a new operator be selected by the majority of the working interest ownership in the proposed unit and in accordance with the terms of the July 6, 1951 Western Natural Gas , et. al. Block 71 Operating Agreement (hereafter "1951 Operating Agreement") which governs operation of the drillsite lease...." Bay Rock characterizes this proposal as a demand that renders the proposal unfair. Bay Rock also objects to statements in Mulvey's closing statements that request that Mulvey be appointed operator. Bay Rock concludes that this is an unfair demand that requires dismissal of the application. Whether a MIPA offer is fair and reasonable must be determined by examining

the document's content at the time of the offer, subsequent attempts at modification notwithstanding.

Bay Rock contends that Mulvey's proposal to operate under the 1951 Operating Agreement is unfair and unreasonable in light of the existence of a subsequent operating agreement which was approved by 31/32nds of all interests bound by the 1951 Operating Agreement. Mulvey argues that he was constrained by the 1951 Operating Agreement and had no knowledge of subsequent operating agreements. Mulvey claims an interest in the drillsite tract derived from the 1951 Operating Agreement which binds him to offer under the terms of that agreement. Bay Rock was aware of this claim. Mulvey was unaware of the subsequent operating agreement and Bay Rock admitted that, although they were aware of Mulvey's 1/32nd interest claim, they did not inform Mulvey of the subsequent operating agreement.

It is well established that a fair and reasonable offer is one that "takes into consideration those relevant facts, existing at the time of the offer, which would be considered important by a reasonable person in entering into a voluntary agreement concerning oil and gas properties." Carson v. Railroad Commission, 669 S.W.2d 315, 318 (Tex. 1984). While it is true that authority exists for the position that the offer must be judged fair and reasonable from the standpoint of the party being forced pooled (Windsor Gas Corp. v. Railroad Commission, 529 S.W.2d 834 (Tex. Civ. App. - Austin 1975, writ dismissed), this situation is distinguishable on the facts. In Windsor, the facts surrounding the offending provision of the offer were well known to all parties while here the existence of the subsequent operating agreement was known only to the offeree and not to the offeror. It is unreasonable to expect an offeror to consider a relevant fact that he neither knew, nor should have known.

Inadequate Offer to Pay Cost

Mulvey's offer included an offer "to pay 125% of the 30.50331% (Mulvey's calculated working interest in the proposed unit) of the actual drilling and completion costs for the above well which are allowed to be deducted under the terms of the 1951 Joint Operating Agreement...." (Mulvey Ex. 1). Bay Rock asserts that this is not fair and reasonable because there is no cash offer to pay costs, cost deductions are to be controlled by the 1951 Operating Agreement, and the well will not pay out. Mulvey replies that he was not offered an opportunity to participate prior to the drilling of the well, that MIPA § 102.052(a) anticipates deduction of cost from production, and failure of the well to pay out is irrelevant.

There is no requirement that a cash risk penalty be included in a MIPA offer to pool. Buttes Resources Co. v. Railroad Commission, 732 S.W.2d 675, 678 (Tex.App.--Houston[14th Dist] 1987). As previously noted, Mulvey made the offer pursuant to the

operating agreement he thought controlled. Whether the well pays out or not is irrelevant to the fairness of the offer.

Proposed Unit Larger than Allowed by Field Rules

Mulvey's offer to pool proposed a 226 acre unit consisting of portions of six tracts. Bay Rock contends that the offer is not fair and reasonable because it purports to form a unit larger than allowed by the field rules. Bay Rock contends that it is unfair to propose a unit that Bay Rock would have been prohibited by Commission rules, to form on its own. Bay Rock also contends that the occurrence of an offer, previously made and withdrawn, to Bay Rock from Mulvey which sought to form a 160 acre unit makes this offer to pool 226 acres unfair or unreasonable.

Arguably, the language of section 102.011 of the MIPA contemplates the formation of a unit up to 640 acres plus tolerance. (Section 102.011 states that the Commission established unit will be approximately the size of the required proration unit and "...shall in no event exceed 160 acres for an oil well or 640 acres for gas well plus 10 per cent tolerance.") Furthermore, the inclusion of acreage that the Commission lacks power to pool, in a proposed unit has been held not to be unreasonable. Id. at 678. The previous offer of 160 acres unit can be viewed as evidence of a willingness to negotiate on the part of Mulvey. Although the examiners believe the appropriate unit size is 176 acres (see Examiners Recommendation, p. 6), the proposal of a 226 acre unit does not make the offer unfair or unreasonable.

Disparagement of Title

Mulvey's offer contains the following paragraph:

> The ownership set out below recognizes that, to date, there has been judicial determination regarding the validity of the leases on Farm Tracts 3364 and 3365 which were assigned to Pecos Development Corporation by Atlantic Richfield Company and Mobil Producing, and should in no event be construed as my recognition of the ownership therein which Pecos and Bay Rock have represented in the public record at the Railroad Commission and in Live Oak County. I believe that you are well aware of my view that the unitized leases covering Farm Tracts 3364 and 3365 both expired from years of non-commercial production long before the establishment of production from the above well, and that the leases taken by Pecos and me in 1987 and thereafter were valid when executed.

Bay Rock asserts that it is not fair and reasonable to make such a claim and then to couch an offer in terms that would require the offeree to assent to them. However, accepting the offer would not require assent to any claim. The paragraph indicates that an

acceptance of the offer does not mean that Mulvey assents to Pecos's claim. It neither implies nor requires an affirmative act on Bay Rock's part. Additionally, Pecos has, in a related lawsuit, filed a counterclaim and a Lis Pendens on all mineral leases held by Mulvey in Blocks 70 and 71. In view of these circumstances, the inclusion of such a disclaimer does not render the offer unfair or unreasonable.

Lastly, it is significant that Bay Rock made no counteroffer to Mulvey and made no attempt to negotiate or respond to Mulvey's offer in any manner. Bay Rock states that they did not communicate with Mulvey because of a history of contentious business dealings and past and present lawsuits. However, Bay Rock could have responded to the offer by communicating with Mulvey's attorney with whom they did communicate on other matters. It is well recognized that the intent of the MIPA is to encourage negotiation and voluntary pooling. In American Operating Co. v. Railroad Commission, the court stated, "The fact that the MIPA was enacted to encourage voluntary pooling would seem to contemplate a process of negotiations among the parties....Although the MIPA does not require that a counteroffer be made in response to a voluntary pooling offer, it is a factor which we consider in making a determination as to whether such an offer is a fair and reasonable offer under the Act." American Operating Co. v. Railroad Commission, 744 S.W.2d 149, 154 (Tex.App.--Houston[14th Dist.] 1987), writ denied. See also Carson v. Railroad Commission, 669 S.W.2d 315, 318 (1984)., failure to negotiate by offeror contributed to holding that the offer was not fair and reasonable, Windsor Gas Corporation v. Railroad Commission, 529 S.W.2d 834 (Tex.Civ.App.--Austin, 1975), writ dismissed as moot, court held that "take it all" or "leave it all" offer was not fair and reasonable.

The examiners believe that the offer was fair and reasonable in light of the circumstances as they existed at the time of the offer.

EXAMINER'S RECOMMENDATION

The evidence shows that the Clayton (Wilcox 7360) Field is trapped in an anticlinal closure associated with a down-to-the-coast normal fault (i.e., rollover fault closure). Production is controlled by structure with off-structure wells producing water. The Pecos Block 71-2 well is located on or near the highest structural position on the proposed unit. Mulvey testified that the well was draining his acreage. Bay Rock's expert witness testified that he doubted that drilling a second well on Mulvey's lease would increase hydrocarbon recovery. The witness also opined that the well would not pay out 125% of the well's drilling, completion and operating costs.

Because an additional well would not increase recovery from the field and because Mulvey is being drained, the examiners

believe that the a MIPA pooling order should be granted. Considering the above, the most appropriate unit is the structurally highest 176 acre (160 acre plus 10% tolerance allowed by the field rules) of the proposed 226 acre unit. Because Mulvey waited three years after the well was drilled and completed to make this offer, a penalty of 100% of the cost of drilling, completing and operating the well, is appropriate. Furthermore, because the well may become noncommercial before the pay out of the penalty, it is appropriate that Bay Rock remain operator, pursuant to the operating agreement they are now operating under, until and unless the working interest owners select a new operator. The area to be pooled will be described by fractional and whole tracts. The ownership interest in those tracts will be dependent on the outcome of the pending civil litigation.

FINDINGS OF FACT

1. Notice of the hearing on this application was given to all mineral interests owners in the manner prescribed by the Commission.

2. Mulvey has applied for a Commission order pooling his interests in Block 71 of the Dr. Charles F. Simmons Nueces River Farm Subdivision in Live Oak County, into the Pecos Development Corporation Block 71-2 Unit, Clayton (Wilcox 7360) Field.

3. Mulvey made an offer, dated August 27, 1991, to all working interest owners in the proposed unit to voluntarily pool his interest in the proposed unit.

4. The August 27, 1991 offer by Mulvey was fair and reasonable under the Mineral Interest Pooling Act.

5. Mulvey is a mineral interest owner in the proposed unit.

6. There are separately owned tracts in the proposed unit.

7. The separate tracts are underlain by the Clayton (Wilcox 7360) Field reservoir

8. The Clayton (Wilcox 7360) Field was discovered on January 11, 1975.

9. Temporary field rules were adopted for the Clayton (Wilcox 7360) Field on March 7, 1988.

10. There are separately owned oil and gas interests within the proposed unit.

11. No voluntary pooling agreement exists for all of the tracts in the proposed unit.

12. Pecos Development Corporation, through its operator, Bay Rock Operating Company, has drilled the Bay Rock Block 71-2 Well on the proposed unit.

13. No State owned land is included in the proposed unit.

14. Bay Rock did not respond to Mulvey's offer.

15. The Bay Rock Block 71-2 Well is draining hydrocarbon from Mulvey's tracts.

16. The drilling of additional wells on the proposed unit will not increase hydrocarbon recovery.

CONCLUSIONS OF LAW

1. Notice of hearing was timely given to the operator and mineral interest owners within the proposed unit and to all other persons legally entitled to notice.

2. All things necessary to invoke the jurisdiction of the commission in this matter have been done and the Commission has jurisdiction.

3. The subject application complies with the requirements of the Mineral Interest Pooling Act, Texas Natural Resources Code §§ 102.001 - 102.112. (Vernon 1978).

4. Establishing the pooled unit described in the attached order will prevent the drilling of unnecessary wells and protect correlative rights.

RECOMMENDATION

The examiners recommend the Commission adopt the Findings of Fact and Conclusions of Law set forth herein and APPROVE the subject application pursuant to the Mineral Interest Pooling Act, in accordance with the attached final order.

Respectively submitted,

Larry Borella
Hearing Examiner

Thomas H. Richter, P.E.
Technical Examiner

LGB/THR/lgb